RSM Richter Inc.

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CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTRÉAL
DIVISION NO.: 01 - Montréal
COURT NO.: 500-11-042467-122
ESTATE NO.: 41-1610492

SUPERIOR COURT
(Commercial Division)

IN THE MATTER OF THE PROPOSAL OF:

4021568 Canada Inc.

a body politic and corporate, duly incorporated according to law and having its head office and its principal place of business at :

9600 Meilleur Street, Suite 925
Montréal, Québec H2N 2E3

Debtor

- and -

RSM Richter Inc.

a duly incorporated legal person having its principal place of business at 2 Place Alexis-Nihon, Suite 2000 in the city and district of Montreal, Quebec, H3Z 3C2

Trustee

REPORT OF THE TRUSTEE ON THE FINANCIAL SITUATION OF THE DEBTOR AND ON THE PROPOSAL (Subsections 50(5) and 50(10) (b) of the *Bankruptcy and Insolvency Act*)

The purpose of the First Meeting of Creditors is to consider the proposal filed on April 4, 2012 (hereinafter referred to as the "Proposal") by 4021568 Canada Inc. (hereinafter referred to as the "Debtor", "Foxy" or the "Company") to its creditors.

Pursuant to Sections 50(10)(b) and 50(5) of the *Bankruptcy and Insolvency Act* (hereinafter referred to as the "Act" or "BIA") and to assist the creditors in considering the Proposal, the Trustee is submitting its report on the financial situation of the Debtor and on the Proposal.

We caution the reader that the information contained herein emanates from the books and records of the Debtor as well as from discussions with the Management of the Debtor. We have not conducted an audit or an investigation of these books and records and, consequently, we cannot render an opinion as to the accuracy of the information contained herein.

I. INTRODUCTION

On April 4, 2012, the Debtor filed with the Trustee, RSM Richter Inc. ("Richter") and the Official Receiver a Proposal to its creditors. On April 13, 2012, Richter proceeded to mail to all known creditors, the Proposal, a Proof of Claim form, a Voting Letter, a Proxy and a Notice indicating the place and time of the Meeting of Creditors to consider the Proposal. The creditors may, in person at the forthcoming meeting of creditors, or by Voting Letter on or before the Meeting of Creditors, accept or reject the Proposal.

The following summarizes the relevant information and key elements that may assist the creditors in analyzing the Debtor's affairs and the terms of the Proposal.

Capitalized terms used herein and not otherwise defined have the meaning ascribed to them in the Proposal.

II. BACKGROUND OF THE DEBTOR AND CAUSES OF INSOLVENCY AND LIQUIDITY CRISIS

The Company was incorporated on May 22, 2002 under Federal Statute. Its main activities consist of the design and wholesale of denim clothing and of sportswear for men and women (the "Wholesale Business"). In addition, the Company operated a retail store in the Fairview Pointe-Claire mall (the "Fairview Retail Store"). The Company's secured lender is the Canadian Imperial Bank of Commerce ("CIBC" or "Bank") who holds a first ranking secured interest on all accounts receivable and inventory (the "Secured Assets") but does not hold any security in respect of the Company's fixed assets, Intellectual Property and other assets.

The Wholesale Business customers are mainly comprised of "low to mid-market" retail chains and independent stores. As the Company's products are subject to fashion trends, its customers require their orders to be filled on a timely basis, prior to the beginning of a particular season. The Company sources its inventory from the Orient which requires significant advance payments.

The Debtor is related to six companies owning retail stores in the following locations: Eaton Center in Montreal (2 stores), Champlain Mall in Brossard, Quebec, Place Rosemère, Quebec, Galeries de La Capitale in Quebec City, Place Laurier in Ste-Foy, Quebec, and Place du Royaume in Chicoutimi, Quebec (collectively the "Retail Stores").

The Retail Stores were opened in the past six years and have been unprofitable, incurring cumulative losses of approximately $2 million.

The Retail Stores have not filed formal proceedings under the BIA; however, they are presently being wound up by the Company's Management (defined below). We refer to the Company and the Retail Stores collectively as the "Foxy Group".

Historically, the Debtor sold the required finished goods inventory to the Retail Stores, on credit. Based on the latest available financial information (as at December 31, 2011), the Retail Stores were collectively indebted to the Debtor in the amount of approximately $3 million, mainly related to intercompany inventory purchases. Given the Retail Stores' unprofitable operations and precarious liquidity position, it is highly unlikely they will be able to repay the amounts due to the Debtor.

The Foxy Group is operated by the Company's two sole shareholders (who are also the sole shareholders of the Retail Stores), namely Messrs Steven Lawee and Franco Di Zazzo (collectively "Management").

Over the last four fiscal periods (which include the current fiscal period to December 31, 2011), the available books and records indicate that the Foxy Group has experienced decreasing revenues and has incurred cumulative losses of approximately $2.3 million.

As a result of the significant recurring operating losses, Richter was mandated on February 17, 2012 by the CIBC to review the Company's financial situation and the Bank's security position. Following Richter's review, it was determined that the Company could not fund its ongoing operations and had failed to meet the margining requirements stipulated in its credit agreement with the CIBC and consequently was in default.

In addition, Richter performed a liquidation analysis (supported by two appraisals of the Company's inventory) which indicated that the Bank would suffer a significant shortfall on its secured advances in the event of an orderly liquidation of the Secured Assets.

On March 16, 2012, the Bank sent the Debtor a Notice of Intention to enforce the Security under section 244 of the BIA.

Given that the Company did not have the required financing to secure its purchase commitments necessary to ship its "Spring 2012" goods to its customers, and that Management was unable to make a capital injection, the Debtor needed to immediately find an investor or an alternate source of financing in order to pursue its operations as a going concern.

III. FINANCIAL INFORMATION

The following financial information was obtained from the available books and records of the Debtor and from discussions held with Management. It is submitted solely to assist the reader in assessing the current financial situation of the Debtor.

The Trustee makes no representations or warranty as to the accuracy of the said financial information.

A) Historical Operating Results

Management prepares only combined annual financial statements for the Foxy Group as required by the Company's credit agreement with the Bank. As such, the operating results summarized below include the Company and the Retail Stores:

Foxy Group
Summary of Operating Results (Unaudited)

	6 mo. ending	Year ending June 30		
	Dec. 31, 2011	**2011**	**2010**	**2009**
Sales	$ 5,139,026	$ 12,169,388	$ 14,470,589	$ 18,441,285
Gross Profit	1,593,236	4,903,175	5,502,863	5,706,135
Operating Expenses	2,764,643	5,391,196	6,030,171	5838267
Net Loss (Note 1)	$ (1,171,407)	$ (488,021)	$ (527,308)	$ (132,132)
Cumulative Net Loss	**$ (2,318,868)**	**$ (1,147,461)**	**$ (659,440)**	**$ (132,132)**

Note 1: Before taxes and excluding extraordinary items.

We refer you to the following section which includes the Debtor's Statement of Affairs which in turn reflects a deficiency in excess of $4 million.

B) Assets and Liabilities

The following summarizes the Company's Statement of Affairs filed on April 4, 2012:

4021568 Canada Inc. Statement of Affairs As at April 4, 2012		
Assets:		
Inventory (pledged)	$	240,000
Accounts Receivable (pledged)		840,000
Intellectual Property		100,000
		1,180,000
Creditors:		
Secured (CIBC)		995,000
Preferred		-
Unsecured		4,253,682
		5,248,682
Deficit	$	(4,068,682)

Following the filing of the Proposal, and as authorized by the Court on April 5, 2012, all of the Company's assets (with the exception of the Remaining Assets – defined - which Management believes have nominal value) have been sold to the Purchaser pursuant to an asset purchase agreement dated April 10, 2012). We refer you to section IV for further details.

<u>Secured Creditors ($995,000)</u>

Based on the net proceeds of the sale of inventory and accounts receivable to be received from the Transaction (as defined in section IV), the Bank expects to suffer a shortfall in the realization of its security of approximately $225,000 (after costs and accrued interest).

<u>Preferred Creditors (Nil)</u>

Based upon the terms and conditions of the Proposal, all employees' claims that qualify under section 60(1.3)(a) of the BIA and all preferred claims will be paid in full in priority of all unsecured claims.

As noted in the following section, as a condition of the Offer (defined below), any outstanding arrears to the Company's employees and amounts payable for DAS are to be paid from the proceeds of the Transaction.

Unsecured Creditors ($4,253,000)

The actual amount of claims from the Company's unsecured creditors will only be determined upon receipt by the Trustee of their proof of claims. As noted below, over 75% of the Company's unsecured creditors in value (based on the Company's books and records) have indicated their support of the contemplated Proposal.

IV. SALE OF ASSETS AND RECEIVERSHIP

In late February 2012, Management attempted to identify potential investors or purchasers for the Company's assets, with the view of continuing operations as a going concern. Richter was not involved in the Company's efforts.

Given the urgency of the situation, resulting mainly from the Company's immediate need to fill the Spring 2012 orders from its customers and for which the requisite funding was not available, Management was of the view that it did not have time to undertake a formal sale process for the Company's assets.

Management approached (3) three parties it identified as potentially having an interest in either the Company or its assets. Following discussions with all parties, a decision was made by Management to limit the negotiations with Fame Jeans Inc. ("Fame"), with whom Management was familiar, and which, in Management's view, represented the best strategic fit as an acquirer or investor. An entity controlled by Fame's principal (the "Purchaser") expressed its interest to acquire the accounts receivable and inventory (i.e. the Secured Assets), as well as the Intellectual Property and certain contractual rights of the Debtor in an attempt to continue the Wholesale Business. The Purchaser was not interested in the Wholesale Business' fixed assets or the assets of the Fairview Retail Store (collectively the "Remaining Assets").

Fame is a client of Richter's audit division. However, pursuant to firm policies, there is no exchange of information between Richter's audit and insolvency practices.

On April 3, 2012, the Purchaser presented to the Debtor an offer (the "Offer") to acquire the Company's accounts receivable, inventory, Intellectual Property and contractual rights. The Offer was conditional on the Company obtaining a Court Order ("Vesting Order") authorizing it to transfer all the purchased assets to the Purchaser, free and clear of any charges, liens and encumbrances (except for amounts due by the Company to its third party warehouse provider - the "Warehouse Lien"). The Purchaser would not assume any of the Company's liabilities. The Offer was also conditional that the outstanding vacation pay owed to the Company's employees and the arrears of deductions at source ("DAS") be paid from the proceeds of sale.

The Offer included an allocation of $100,100 for the Intellectual Property (and contractual rights) with the balance of the purchase price being for the Secured Assets. Subsequent to the completion of the sale to the Purchaser, it is estimated that the Secured Lender (“CIBC”) would suffer a loss of approximately $225,000 (after costs and accrued interest).

Richter understands that it is also the intention of the Purchaser to offer employment to all former employees of the Debtor working in the Wholesale Business, as well as Management.

The Company or Richter did not obtain a formal valuation of the Intellectual Property. Notwithstanding that the Company derives a portion of its revenues by licensing its Intellectual Property, the insolvency of the Debtor, combined with its inability to maintain operating activities, would have a significant adverse effect on the market value of the Intellectual Property. Management is of the opinion that the permanent closure of the operations would in all likelihood reduce the market value of the Intellectual Property to a nominal amount, and therefore believes that a transaction which would allow operations to continue with minimal interruption would protect the value of the Intellectual Property for the benefit of the Company’s unsecured creditors.

As the amount of $100,100 allocated to Intellectual Property (and contractual rights) accrues to the benefit of the Company’s unsecured creditors, Management sought the input of the Company’s major unsecured creditors on the proposed transaction and ensuing Proposal. **Six (6) creditors representing more than 75% (~$3.3 million out of ~$4.2 million) of total unsecured creditors provided the Company with letters confirming their approval of the proposed transaction and advised the Company that they would vote in favor of the Proposal despite the fact that they would recover only a nominal portion of amounts owed to them by the Debtor (the “Support Letters”).**

On April 5, 2012, the Bank made a motion to the Court for the appointment of Richter as Receiver and for the authorization of the sale of the Company’s assets to the Purchaser pursuant to the Offer (the “Transaction”). On the same date, the Court granted the Order as requested.

V. PROPOSAL TO CREDITORS

As previously indicated, on April 4, 2012, the Company filed a Proposal to its creditors.

Creditors are advised to read the more detailed text of the Proposal as well as associated definitions.

The highlights of the Proposal can be summarized as follows:

- Any secured claims shall be paid in accordance with arrangements existing between the Debtor and holders of secured claims ;
- The amounts that employees would be qualified to receive under section 136 (1)(d) of the BIA shall be paid in full immediately after ratification of the Proposal. Pursuant to the terms of the Offer, these amounts were paid by the Company upon closing of the Transaction;
- The Proposal Expenses, including all professional fees, will be paid in full, in priority to all Preferred Claims and Unsecured Claims of creditors;
- The Crown's Claims, if any, shall be paid in full, without interest, within six months of the approval as defined in the Proposal (pursuant to the terms of the Offer, these amounts will be paid from the proceeds of the Transaction);
- The Preferred Claims, if any, shall be paid, without interest in full, in priority to all Unsecured Claims;
- The funds available for distribution to the creditors under the Proposal (the "Basket Amount") are comprised of:
    - o The proceeds from the sale of the Intellectual Property (and contractual rights) to the Purchaser ($100,100); plus
    - o The proceeds from the sale by the Company of the Remaining Assets (amount to be determined but likely nominal); less
    - o The Proposal Expenses (principally the Trustee's fees and disbursements); less
    - o The amounts payable by the Company for post-filing goods and services.
- In complete satisfaction and discharge of all Unsecured Claims, the unsecured creditors shall receive from the Basket Amount the following:
    - a) The lesser of each unsecured creditor proven claim and $1,000 (the "First Level Distribution"); and
    - b) An amount equal to the unsecured creditor pro rata share, based on the balance of its proven claim, of any amount remaining from the Basket Amount, after payment of the First Level Distribution.

- The Proposal will constitute a compromise of claims against the present and past Directors of the Company that arose before the filing of the Proposal and that relate to obligations where the Directors are by law liable in their capacity as Directors (the "Directors' Obligations"). The Proposal, upon approval, will operate as a discharge of the Directors' Obligations. (Nothing herein shall be interpreted as an acknowledgment of any liability or obligation of the Directors of the Company);

- The statutory terms of sections 95 to 101 of the BIA (related to preferences, transfers at undervalue etc.) shall not apply;

- The claims of Messrs. Lawee and Di Zazzo relating to shareholder loans (in the amount of $33,000 each) will be subordinated until the Company's unsecured creditors receive their dividends under the terms of the Proposal.

VI. CONCLUSIONS AND RECOMMENDATIONS

If the unsecured creditors reject the Proposal, the Company will automatically be deemed to have filed an assignment in bankruptcy. Thereafter, the net proceeds from the sale of the Intellectual Property (and contractual rights) and of the Remaining Assets will be distributed by the Trustee to the creditors based on the provisions of the BIA.

As noted above, with the Approval of the Proposal, all the creditors waive their remedies provided by sections 38 and 95 to 101 of the BIA. These remedies relate to the recovery of certain amounts for possible preferential payments and/or transfers at undervalue.

Since these remedies would be available in the event of a bankruptcy of the Debtor, we have performed a cursory review of the available books and records including various transactions involving the Debtor, non-related third parties and related parties over the three (3) months and twelve (12) months, respectively, prior to the filing of the Proposal. Pursuant to our cursory review, there do not appear to be any transactions which may be subject to sections 95 to 101 of the BIA.

Although the gross recovery of the Company's assets available to unsecured creditors subsequent to an accepted Proposal is not materially different from a bankruptcy, a bankruptcy would however entail significantly higher costs, thus eroding the net amount that would be available to the unsecured creditors.

The following additional qualitative factors should be considered in evaluating the Proposal:

- A large portion of the Company's unsecured creditors (over 75% in value based on the Company's books and records) have provided to the Debtor their consent to the sale Transaction and their intention to vote in favor of the Proposal, notwithstanding that they would absorb significant losses;

- Approximately 45% of the unsecured creditors, being creditors with claims of $3,000 or less, will receive all or substantial portion of their claim. In a bankruptcy scenario, these creditors would only receive a nominal amount.

In view of the foregoing, the Trustee recommends that the creditors accept the Proposal.

Dated at Montréal, Province of Quebec, this 11th day of April, 2012.

RSM Richter Inc.
Trustee

Carl Adjami, CA, CIRP for

Gilles Robillard, CA, CIRP
Administrator